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State of New Jersey

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December 17, 1999

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ECFS AND OVERNIGHT MAIL
Ms. Magalie Roman Salas
Office of the Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Room TW-A325
Washington, DC 20554

Re: **I/M/O** Implementation of the Pay Telephone Reclassification and Compensation Provisions Of the Telecommunications Act Of 1996 Michigan Pay Telephone Association's Petition for Declaratory Ruling Regarding The Prices Charged by Ameritech Michigan And GTE North, Inc. For Network Access Services Made Available to Payphone Providers in Michigan.

Dear Secretary Salas:

The New Jersey Division of the Ratepayer Advocate hereby submits its comments, as electronically filed, in response to the Public Notice in the above-referenced docket. The due date for Comments is December 17, 1999.

Very truly yours,

Blossom A. Peretz, Esq.,
DIVISION OF THE RATEPAYER ADVOCATE

By: Christopher J. White
Christopher J. White, Esq.
Asst. Deputy Ratepayer Advocate

CW/dlc

cc: Chief, Competitive Pricing Division
Jon Stover, FCC CPD/CCB
ITS, Inc.

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Federal Communications Commission

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New Jersey Division of the Ratepayer Advocat

...and Thank You for Your Comments

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the matter of	)	
	)	
Implementation of the Pay Telephone Reclassification and Compensation Provisions Of the Telecommunications Act Of 1996	)	CC Docket No. 96-128 CCB/CPD No. 99-35
	)	
Michigan Pay Telephone Association's Petition for Declaratory Ruling Regarding The Prices Charged by Ameritech Michigan And GTE North, Inc. For Network Access Services Made Available to Payphone Providers in Michigan.	)	

COMMENTS ON BEHALF OF THE
NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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INTRODUCTION & EXECUTIVE SUMMARY

The Division of the Ratepayer Advocate ("Ratepayer Advocate"), an independent agency of the State of New Jersey representing the interests of all classes of New Jersey consumers submits its comments in response to the Federal Communications Commission's ("FCC's") Public Notice, DA 99-2509.[1] The FCC seeks comments on the Michigan Pay Telephone Association's ("MPTA's") petition for declaratory ruling.[2]

For the reasons discussed below, the Ratepayer Advocate asks the FCC to reaffirm that:

(1) the Michigan Public Service Commission ("MPSC") was obligated to commence a proceeding to review the intrastate payphone tariffs filed by Ameritech Michigan ("Ameritech") and GTE North, Inc. ("GTE");

(2) the burden of proof to demonstrate compliance with the FCC Federal standards is on Ameritech and GTE;

(3) Federal standards must be applied and inconsistent and conflicting state standards are preempted under Section 276(c) of the Act;

(4) the new services test applies in determining the direct cost and overhead loadings as a price floor for a service offering;

(5) a consistent pricing methodology must be used and applied, but TSLRIC pricing methodology is permitted though not required in determining rates for services in and between payphone tariffs;

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1 *See Public Notice*, DA 99-2509 was released November 12, 1999, CCB/CPD No. 99-35. Comments are due on December 17, 1999 and reply comments are due on January 5,1999.

2 The MPTA seeks a ruling from the FCC declaring: (1) that the appropriate cost standard to be used in question is a forward looking economic cost methodology that is consistent with state law:(2) that the appropriate cost standard to be applied in calculating a "reasonable amount" for overhead is a forward looking economic cost methodology that is consistent with state law; (3) that the prices for network services made available to payphone providers be set to not produce revenue that subsidize either the direct costs or the overhead costs associated with other non-payphone services; (4) that the end user common line (EUCL) revenue and other rate elements paid by the payphone providers for non-traffic sensitive costs be attributed to offset the costs associated with the access lines, such that, the rate plus the EUCL would recover the economic cost of the non-traffic sensitive costs of the service; and (5) that the Michigan PSC not rely upon non-cost-based business service rates when setting the rates for payphone services under the new services test. *See Public Notice* at pages 1 and 2.

(6) the tariff rate for the same or similar services must be priced consistently, uniform overhead and profit loadings are required for the same or similar services, and non-uniform overhead and profit loading are permissible for different services, if justified;

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(7) payphone tariffs must contain no subsidies, be non discriminatory and otherwise comply with Sections 201 and 202 of the Act;

(8) a FDC subsidy analysis is to be used to identify subsidies;

(9) MPSC may not rely on previously filed and approved state tariffs as a substitute for performing its own analysis to determine compliance with the FCC's Federal standards and that analysis must demonstrate that intrastate tariffs are cost based, contain no subsidies, are nondiscriminatory, and are otherwise consistent with the Act, including the FCC's nonstructural safeguard standards; and

(10) only the direct costs for the separated loop are used to establish the price floor for the payphone line (costs reimbursed through the SLC are not included).

BACKGROUND

Section 276(a) of the Federal Telecommunications Act of 1996 ("Act" or "1996 Act")[3] directed the Federal Communications Commission ("FCC") to prescribe a set of nonstructural safeguards for Bell Operating Companies ("BOCs") payphone service to implement the Act's requirements that any BOC: (1) shall not subsidize its payphone service directly or indirectly from its telephone exchange or exchange access service operations; and (2) shall not prefer or discriminate in favor of its payphone service.[4] Under Section 276(b) of the Act, the FCC was charged by Congress to issue regulations that would (1) establish a per call compensation plan to ensure that all payphone providers are fairly compensated for calls; (2) discontinue the intrastate and interstate carrier access charge payphone service elements and eliminate all subsidies from basic exchange and

[3] The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, codified at 47 U. S.C. §§ 151 et seq.

[4] 47 U.S.C. § 276(a). The FCC's orders and regulations apply to all Incumbent Local Exchange Carriers ("ILECs") as well as BOCs.

exchange access revenues; and (3) provide a set of nonstructural safeguards -- which at a minimum must include the nonstructural safeguards adopted in the *Computer Inquiry-III* -- for BOCs to implement the objectives of the Act.[5] The FCC adopted nonstructural safeguards to detect and remove subsidies that existed in BOCs' payphone operations.

Historically, BOCs had offered two types of lines for payphone use: (1) a network controlled Line (NCL) and (2) a Customer Owned Customer Operated Telephone (COCOT) line. BOCs' payphones used NCL lines almost exclusively with payphone sets referred to as "dumb" payphones. A "dumb" payphone is a payphone set with all functions related to operation of the payphone performed at the central office. BOCs did not make NCL lines available to Independent Payphone Service Providers ("IPSP"). BOCs' NCL line service is a bundled service which includes several bundled elements and features such as answer supervision and call screening. BOCs only made COCOT lines available to IPSPs which used "smart" payphones. "Smart" payphones have a computer board in the phone that performs most, if not all, of the central office functions that the NCL line provides to BOCs payphones. BOCs did not file tariffs for NCL lines. But, BOCs offered COCOT lines under filed tariffs known as COCOT tariffs. COCOT tariffs set forth the elements and features that an IPSP may select on an unbundled basis.

The FCC adopted various regulations implementing Section 276 of the Act. The *Payphone Order* and the *Reconsideration Order,*[6] required BOCs to implement nonstructural safeguards to

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5 47 U.S.C. § 276(b).

6 See *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No.. 96-128, Report and Order, 11 FCC Rcd 20541 (1996) (*Payphone Order*) and *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Order On Reconsideration, 11 FCC Rcd 21233 (1996) (*Reconsideration Order*)

ensure that nondiscriminatory service is available to all payphone operators and to ensure that any payphone operator has the option to use either "dumb" or "smart" phones or any combination of the two. The FCC required that BOCs, including ILECs, either reclassify their payphone assets to a non regulated payphone account or transfer such assets to an affiliate or a separate operating division. Thus, payphone assets are treated for regulatory purposes as a nonregulated service. Payphone assets includes all facilities related to payphone service **with the exception of network services which would continue to be provided by the LEC as regulated services**. The FCC's orders require that services provided to payphones by BOCs are regulated services and must be provided under tariffs. In particular, the FCC stated at paragraph 169 of its *Reconsideration Order* that:

> We conclude that the payphone assets to be reclassified or transferred include all facilities related to payphone service, with the exception of loops connecting the payphones to the network, the central office "coin-services," and operator service facilities supporting incumbent LEC payphones.

Network services include transmission services which include local loop, central office coin services and operator service facilities. These transmission services are part of the network equipment necessary to support basic telephone services.[7]

The FCC reiterated in its *Reconsideration Order* at ¶ 162 -- that the FCC requires in accordance with its *Payphone Order* -- that LECs must provide any network service upon request, when the FCC stated:

> In addition, as required by the Report and Order, any basic network services or unbundled features used by a LEC's operations to provide payphone services must be similarly available to independent payphone providers on a nondiscriminatory, tarriffed basis.

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[7] See ¶ 159 of the Payphone Order that provides that these three services are part of the network equipment necessary to support basic payphone service.

As a result, the FCC requires the filing of Federal and state tariffs for basic payphone services provided by the BOCs to its payphones and to COCOT payphones.[8] These payphone tariffs must be cost based, contain no subsidies, and be nondiscriminatory. Under the *Reconsideration Order*, BOCs were required to file a Comparably Efficient Interconnect (CEI) plan for payphone service and have the plan approved by the FCC. The CEI plan had to describe how the BOC would comply with the FCC's equal access and nonstructural safeguards for the provisions of nondiscriminatory payphone service for NCL and COCOT service. As part of the CEI Plan, the BOC had to certify that (1) it has an effective cost accounting manual ("CAM") filed with the FCC; (2) it has an effective interstate CCL tariff reflecting a reduction for deregulated payphone costs and reflecting additional multiline subscriber line charge ("SLC") revenue; (3) it has effective intrastate tariffs reflecting the removal of charges that recover costs of payphones and **any intrastate subsidies**; (4) it has deregulated and reclassified or transferred the value of payphone customer equipment ("CPE") and related costs as required in the Payphone Order; (5) it has in effect intrastate tariffs for basic payphone service (for both "dumb" and "smart" payphones); and (6) it has in effect intrastate and interstate tariffs for unbundled functionalities associated with those lines.[9]

Each BOC submitted a CEI plan and the FCC approved the various CEI plans. As a result, IPSPs can now offer payphone service using either "smart" or "dumb" payphone sets or some combination of the two in a manner similar to Local Exchange Carriers ("LEC"). At the Federal level, the FCC required BOCs to file Federal tariffs for payphone-specific, network based features

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8 *See Reconsideration Order* at ¶¶ 162-167.

9 *See Reconsideration Order* at ¶¶ 131-132.

and functions that they provided separately and on an unbundled basis from the basic payphone line. The BOCs filed the appropriate tariffs. The FCC instructed the BOCs to file additional Federal tariffs if any of the following circumstances occurred: (1) if a BOC chose to unbundle additional payphone-specific features and functions, (2) if states require further unbundling, or (3) if an IPSP requests additional unbundled features and functions through the Open Network Architecture ("ONA") 120-day service request process.

In addition to Federal tariffs, the FCC directed that state tariffs be filed for NCL and COCOT payphone service offerings. State tariffs and Federal tariffs had to be cost based, contain no subsidies and be nondiscriminatory. The FCC defined cost based to mean that tariffs must be priced in accordance the "new services test" set forth in 47 C.F.R. § 61.49. The new service test is a cost-based test that establishes the direct cost of providing the new service as a price floor and then a reasonable level of overhead is added to derive the overall price of the new service.[10] If the tariff price of a service exceeds the price floor established under the new service test, the tariff is cost based. Thereafter, the tariff must be reviewed for compliance with the FCC's other requirements which include that tariffs contain no subsidies, are nondiscriminatory, and comply with Sections 201 and 202 of the Act.[11] The FCC delegated to the State commissions, the obligation to review state tariffs for compliance with Section 276 of the Act and the FCC's implementing regulations.[12] On

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[10] *See I/M/O/ Local Exchange Carriers' Payphone Functions and Feature; Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 1; GTE System Telephone Companies Revisions to Tariff F.C.C.. No. 1; GTE Telephone Operating Companies Revisions to Tariff F.C.C. No.* 1, FCC 97-392, *Memorandum Opinion and Order* at ¶ 2 (released October 29, 1997) (*Memorandum Opinion and Order*).

[11] 47 U.S.C. §§ 201 and 202.

[12] *See Reconsideration Order* at ¶163; see also *Id*. at n. 492 (noting that the "new services test required in the Payphone Order is described at 47 C.F.R. Section 61.49(g)(2)"); *See I/M/O/ Bell Atlantic Telephone Companies' Comparably Efficient Interconnection Plan for the Provision of Basic Payphone Service; Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act*

the other hand, if the tariff price is below the price floor then the price is below incremental costs. Pricing below incremental costs raises predatory pricing issues. The FCC has acknowledged that the new services test is comparable to incremental costs.[13]

The FCC mandated certain accounting safeguards for all tariffs. In particular, the FCC required BOCs to comply with five safeguards: (1) establishment of effective accounting procedures, in accordance with Commission's Part 32 Uniform Systems of Accounts requirements and affiliate transactions rules, as well as the Commission's Part 64 cost allocation standards; (2) the filing of cost allocation manuals (CAMs) reflecting the accounting rules and cost allocation standards adopted by each BOC; (3) mandatory audits of carrier cost allocations by independent auditors, who must state affirmatively whether the audited carrier's allocations comply with their cost allocation manuals; (4) the establishment of detailed reporting requirements and the development of an automated system to store and analyze the data; and (5) the performance of on-site audits by Commission staff. The FCC's approval of every CEI Plan was conditioned upon each BOCs' compliance with these five safeguards and each BOC's commitment to file changes to its CAM to cover the accounting revisions necessary to reflect the transfer of payphone assets to a nonregulated service.

A Cost Allocation Manual Is A Tool For Identifying Subsidies

The FCC in 1987 established two complementary sets of rules, one governing how carriers allocate their costs between regulated and non regulated activities, and the other governing

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of 1996, DA 97-791, 12 FCC Rcd 4275, at ¶¶ 62-63 (1997).

13 *See I/M/O Deployment of Wireline Services Offering Advanced Telecommunications Capability; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, FCC 99-355, *Third Report and Order In CC Docket No. 98-147; Fourth Report and Order in CC Docket No. 96-98* at ¶ 140 (released December 9, 1999) (*Line Sharing Order*)

transactions between regulated and non regulated lines of business. These rules ensure that regulated services do not improperly subsidize non regulated services. Subsidization can occur in two ways: (1) by pricing services provided by the regulated portion of the business to the non regulated portion of the business below cost, and (2) by pricing services provided by the non regulated portion of the business to the regulated portion of the business at inflated prices. As a result of the FCC's deregulation of payphone assets, the FCC directed the BOCs to revise their CAM filings to reflect the new regulatory treatment of payphones. BOCs' network services would remain regulated services provided under filed tariffs while payphone operations to the public would be a non regulated service. The FCC approved the revised CAM filings in June of 1997.[14] The FCC in the *CAM Approval Order*, emphasized the appropriate standards for pricing transactions between regulated and non regulated business lines for payphone services when it stated at ¶ 7:

> Section 32.27 of the Commission's rules prescribe rules that govern transactions between a carrier and its nonregulated affiliates (footnote omitted). Section 32.27(b) protects ratepayers by requiring that when an unregulated affiliate transfers assets to or performs services for the carrier, those assets or services are not charged to the carrier's regulated operations at an inflated price. Similarly, when the carrier transfers assets to or performs services for an unregulated affiliate, section 32.27(c) ensures that the regulated operations are compensated for the full value of such assets or service (footnote omitted). These rules protect against subsidization of unregulated affiliates by regulated operations, which could be both anticompetitive and detrimental to ratepayers.

These rules result in the segregation and apportionment of revenue and expenses between the BOCs payphone operations and the BOC's regulated operation which assists in the identification and elimination of subsidies. Under this framework, the purchase of network services from the regulated side of the BOC are expenses to the payphone operation and revenue to the BOC's

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[14] *See I/M/O Local Exchange Carriers Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs*, DA 97-1244, (released June 13, 1997) (*CAM Approval Order*)

regulated operation. If payphone revenues of the BOC's payphone operation exceed payphone expenses incurred by the BOC's payphone operation, a subsidy does not exist from regulated services. Similarly, if regulated services are provided above cost, and at fully distributed costs, no subsidy can exist.

The FCC Directed State Commissions To Apply Federal Standards

The FCC directed State commissions to review all payphone tariffs and determine whether tariffs are cost based, contain no subsidies, are nondiscriminatory, and are otherwise consistent with the Act, including the FCC's nonstructural safeguards. The FCC rejected the position that the FCC should review the reasonableness of payphone service tariffs in light of tariffs filed at the state level.[15] The FCC stated clearly that State commissions must apply the FCC requirements to new and previously filed tariffs as part of the review of intrastate payphone tariffs.[16] An independent analysis must be made. One can not assume that previously approved tariffs comply with the FCC's payphone requirements.

On the Federal level, the FCC directed the BOCs to eliminate the carrier line common charge ("CCL") subsidy. BOCs were directed to reduce their interstate CCL charges by an amount equal to the interstate allocation of payphone costs currently recovered through those charges. In addition, the FCC required that BOCs remove from their regulated intrastate and interstate rate structures all other payphone subsidies.[17] As a result, BOCs were required to file revised tariffs no later than

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15 *See Memorandum Opinion and Order* at ¶ 12.

16 *See Reconsideration Order* at ¶ 163.

17 At the Federal level, BA as a price cap LEC had to use the following method to remove payphone costs from its CCL rates: (1) BA had to develop a common line revenue requirement using ARMIS costs for calendar year 1995; (2) BA had to develop a payphone cost allocator equal to the payphone costs in Section 69.501(d) divided by total common line costs, based upon 1995 ARMIS data; and (3) BA had to reduce its PCI in

January 15, 1997 with the Common Carrier Bureau to reduce their interstate CCL charges by an amount equal to the interstate allocation of payphone costs currently recovered through those charges and file state tariffs no later than April 15, 1997 that reflected the removal from its intrastate basic payphone service rates any charges that recover the costs of payphones. More importantly, the FCC required states to determine the intrastate rate elements that must be removed to eliminate any intrastate subsidies.

All payphone tariffs whether filed at the FCC or with States are subject to and must be reviewed for compliance with the FCC's requirements. As discussed above, the FCC delegated to the states the authority to review all intrastate payphone tariffs and the FCC required states to apply these requirements and the *Computer III* guidelines for tariffing such intrastate services.[18]

Section 276(c) of the Act grants the FCC authority to preempt state requirements that conflict with or that are inconsistent with the FCC's Federal standards. Thus, the FCC has the authority to regulate intrastate matters regarding payphones and preclude inconsistent or conflicting regulations by State commissions. The FCC's jurisdiction and authority to regulate payphones including imposing mandatory Federal standards on the states was sustained on review by the District of Columbia Court of Appeals. The Supreme Court of the United States declined to grant certiorari

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the common line basket by this payphone cost allocator minus one.

[18] *See Implementation of the Payphone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket 96-128, Order, 12 FCC Rcd. 20997 at ¶ 2 (1997) (*Payphone Clarification Order*); Paragraph 2 provides in pertinent part: "Tariffs for payphone services, including unbundled features and functions filed pursuant to the *Payphone Reclassification Proceeding*, must be cost-based, nondiscriminatory, and consistent with both consistent Section 276 and the *Computer III* tariffing guidelines." The RBOC Coalition in this proceeding argued that the new services test did not apply to state tariffing of payphone services. The FCC flatly rejected that argument in ¶¶ 31-32 of the *Payphone Clarification Order*.

from the decision of the District of Columbia Court of Appeals on March 30, 1998.[19] Therefore, State commissions by law must follow the FCC standards in the review of intrastate payphone tariffs.

The MPSC Failed To Review Ameritech's and GTE's Intrastate Payphone Tariffs For Compliance With Federal Standards.

The MPSC made procedural and substantive errors inconsistent with the FCC's payphone orders in its review of the intrastate payphone tariffs filed by Ameritech and GTE. The MPSC made two obvious errors: (1) the MPSC improperly refused to initiate a proceeding in the first instance, and (2) the MPSC improperly placed the burden of proof for showing compliance with the FCC standards on the petitioner. After Ameritech and GTE filed their intrastate payphone tariffs, the MPSC had but two options: (1) open a proceeding and review the tariffs, or (2) decline such review and direct Ameritech and GTE to file these tariffs with the FCC.[20] The MPSC did neither. The MPSC frustrated timely review of these intrastate tariffs by accepting them as filed and refusing to initiate a proceeding as initially requested by the MPTA.[21] Instead, the MPSC imposed on the MPTA the obligation to file a complaint and placed on them the burden of proof in violation of applicable FCC standards.[22]

The Ratepayer Advocate submits that Ameritech and GTE have the burden of proof to show that their intrastate tariffs comply with all FCC Federal standards. The FCC directed all ILECs,

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19 *See Illinois Public Telecommunications Association v. The Federal Communications Commission et al.*, 117 F.3d 555(D.C. Cir. 1997), *amended* 123 F.3d 693 (D.C. Cir. 1997), *certiorari denied*, March 30, 1998, 1999 US LEXIS 2146, 66 U.S.L.W. 3639.

20 See Reconsideration Order at ¶ 163.

21 See MPTA's Petition for Declaratory Ruling at ¶ 13.

22 *Id.* at 14.

which include Ameritech and GTE, to file Federal and intrastate tariffs. They filed tariffs. Consistent with paragraph 131 of the FCC's *Reconsideration Order*, the ILECs certified that they complied with the six conditions for receipt of dial around compensation.[23]

These six conditions arise from the FCC's decision to adopt Federal standards for payphones. In imposing these Federal standards, the FCC directed compliance with the new services test set forth in 47 C.F.R. § 61.49. The new services test requires the ILEC to provide documented cost support, work papers, and statistical data with complete explanations of all estimates for tariffs proposing new services. In particular, the ILEC must provide a study containing a projection of costs for a representative 12 month period, demand estimates for the same period to show the effect that the tariff will have on traffic and revenues for the same services as well as other services, and provide cost data sufficient to establish that such charges will not recover more than a just and reasonable portion of a carrier's overhead.[24] The FCC declared explicitly that "state payphone tariff proceedings are the appropriate fora to address concerns about rates, terms and conditions offered in state payphone service tariffs."[25]

All of these factors lead the Ratepayer Advocate to conclude that the burden of proof is on Ameritech and GTE. The Ratepayer Advocate believes that the FCC decision to reject GTE's selective class of call screening charge in GTE's Federal tariff filing shows that the FCC intended ILECs to have the burden of proof. The FCC found GTE's selective class of call screening charge

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23 See for example, *I/M/O/ Ameritech's Plan to Provide Comparably Efficient Interconnection Plan to the Providers of Pay Telephone Service; Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, DA 97-790, 12 FCC Rcd 4238 at n.14 (1997) (*Ameritech's CEI Order*)

24 See 47 C.F.R. §§ 61.49(g)(1), (g)(1)(i), (g(1)(ii), (g)(2) and 61.49(f)(2)

25 See *Ameritech's CEI Order* at ¶ 72.

to be unlawful because GTE failed to explain how the charge was derived consistent with the new services test. See *Memorandum Opinion and Order* at ¶ 23. We respectfully ask that the FCC reaffirm that the burden of proof is on the tariff sponsors to show that all payphone tariffs as of April 15, 1997 comply with the FCC Federal standards.

MPSC Must Determine Whether The Intrastate Tariffed Rates Under Review Are Nondiscrimiantory, Contain No Subsidies, and Comply with Sections 201 and 202 Of The Act.

In our view, Ameritech and GTE must supply the information necessary to show that the NCL and COCOT tariffs under review contain no subsidies, are nondiscriminatory and comply with Sections 201 and 202 of the Act. Although Ameritech and GTE cannot set a rate for the service below the floor (the service's direct costs plus a reasonable overhead), Ameritech and GTE may select any rate above the floor provided that the selected rate is not contrary to the FCC's Federal standards. The Ratepayer Advocate submits that a rate in a payphone tariff would be contrary to the FCC Federal standards if:

(1) the rate for a feature/service was discriminatory;

(2) the rate violated Sections 201 and 202 of the Act;

(3) the rate caused payphone expenses to exceed payphone revenues (a subsidy); and

(4) the rate precluded a payphone operator from offering payphone service using either "smart" or "dumb" payphones or some combination of the two.

The Ratepayer Advocate asks the FCC to reaffirm that the MPSC is obligated to review these tariffs for compliance with the FCC Federal standards.

To Avoid Discrimination, A Consistent Pricing Methodology Is Required But TSLRIC Methodology Is Not Required.

Although Ameritech and GTE have the discretion to use forward looking economic cost principles, such as Total Service Long Run Incremental Cost (TSLRIC) in determining what tariff rates should be for intrastate payphone services, Ameritech and GTE are not required to use TSLRIC pricing methodology[26]. The Ratepayer Advocate interprets the FCC's payphone orders as permitting any number of pricing methodologies. They could use fully distributed costs, embedded costs or some other generally accepted form of pricing. Whatever pricing methodology is selected, the selected methodology must be used for both NCL and COCOT tariffs. That is, one could not use TSLRIC for pricing COCOT tariffs and fully distributed costs for pricing NCL tariffs. If service offerings are different within a tariff, the FCC does not require that overhead loadings be uniform. Two different service offerings may have different overhead loadings. However, the FCC requires the ILEC to fully justify the loading methodology and any deviations from that methodology. See *Memorandum Opinion and Order* at ¶ 13. The Ratepayer Advocate believes the FCC intended that profit loadings be treated in the same manner as overhead loadings. Any difference in profit loadings must be justified and any deviations fully justified.

The Ratepayer Advocate submits that this rule does not apply to identical services or functionally equivalent services that are offered in more than one tariff. If the identical service or a functionally equivalent service is offered in two payphone tariffs, it must be offered at the same price. By way of example, if answer supervision is provided to payphone operators under both NCL

[26] TSLRIC applies to services and Total Element Long Run Incremental Cost ("TELRIC") applies to discrete elements. They both rely upon forward looking costs. Since payphone is a service, use of TSLRIC is appropriate. TELRIC is not. See *Line Sharing Order*, at ¶ 138. The FCC concluded that TELRIC was intended to price "discrete network elements or facilities" rather than service but acknowledged that it could be extended to cover line sharing.

tariffs and COCOT, as a service offerings, the rates can not differ. The Ratepayer Advocate bases this conclusion on the FCC's *Memorandum Opinion and Order, Supra.* In that order, the FCC reviewed six service offering tariffed at the federal level by Bell Atlantic. As an unbundled service, these six service offering have to be tariffed at the state level, as well. The FCC was explicit and held that overhead loadings for each service did not have to be uniform but that nonuniform loadings had to be justified. See *Memorandum Opinion and Order* at ¶ 13. Thus, each service when tariffed at the state level would have the same tariff rate for that service at the federal level and vice-versa. One can not have two rates for the same payphone service when the service is offered in more than one tariff. If rates for the same service differed between tariffs, it would constitute unjust discrimination.

There is only one situation in which a functionally equivalent service can have different rates. That can occur, if a service is offered on a bundled basis, and also offered on an unbundled basis. The NCL line and the COCOT line are functionally equivalent to one another. They provide dial tone to the payphone operator so that payphone customers may make telephone calls. The NCL line is a bundled service and the COCOT line is an unbundled service. The one element common to both the NCL line and the COCOT line is the local loop. That common component, the local loop, should be priced the same. The rate differences between the NCL and COCOT line should be attributable to the bundled components not utilized by the COCOT line.

The pricing methodology chosen for both lines should be the same. If common component pricing is based upon TSLRIC, then the pricing of noncommon components must be based upon TSLRIC. One must be able to identify what the cost difference are between the two lines. Rates differences for COCOT line and NCL lines should be traceable to the cost of the noncommon components of the bundled NCL line as determined in accordance with the applicable pricing methodology chosen by Ameritech or GTE. Therefore, rate differences between the two lines should reflect only the cost difference for the noncommon components associated with the bundled service adjusted by the overhead and profit loadings applied.

For bundled and unbundled payphone lines, the overhead loading must be identical for both and the profit loading should be identical for both. The loadings can be represented as a fixed amount or an amount based upon a percentage of cost. The profit and overhead loadings need not be the same. One could have an overhead loading of 10% and a profit loading of 8%. The cumulative total for overhead and profit applicable to both would have to be the same in this example 18%. Nonidentical loadings on the payphone line would constitute unjust discrimination.[27]

The Ratepayer Advocate asks the FCC to reaffirm that the above interpretations are correct.

Subsidies Must Be Determined In Accordance With A Fully Distributed Cost Analysis

The Ratepayer Advocate asks that the FCC reaffirm that in the review of intrastate payphone tariffs, State commissions must employ a fully distributed cost analysis ("FDC") to determine if subsidies exist. On more than one occasion, the FCC has articulated why an FDC methodology is appropriate for assessing subsidies in services. In Docket No. 18128, the FCC expressed the value of an FDC-type analysis in identifying cross-subsidies:

> The relative characteristics and merits of FDC Method 1 and 7 were also outlined earlier (see Section XI). It was recognized that although not ideal, these two methods can provide a valuable guide for determining the justness and reasonableness of present and past return levels and relationships at issue herein. The results of analysis of return on investment in accordance with FDC Methods 1 and 7 provide a "zone of reasonableness" which enables us to evaluate the lawfulness of Bell's

[27] *See Line Sharing Order* at ¶139 and footnote 326 (LECs may charge no more to competitors than they charge themselves for loop access). To do otherwise, raises price squeeze concerns. *Id.* at 141.

> return levels. Although not necessarily perfect, these methodologies together are sufficient to identify cross-subsidization and provide carrier accountability.[28]

Furthermore, the FCC rejected a LRIC-type analysis for assessing subsidies in the same docket:

> We have found above that a strict marginal costing approach to pricing cannot be practically implemented under real-world telecommunications industry conditions. We have also found that Bell's LRIC analysis is neither theoretically acceptable nor commensurate with our statutory mandate to ensure just, reasonable and non-discriminatory rates. We must accordingly conclude that LRIC cannot be used to determine whether the return level for Bell's major interstate categories of services are just, and reasonable with the meaning of Section 201(b). [29]

In Docket No. 2003, the FCC reiterated its findings from the *Memorandum and Order* concerning the advantages of an FDC analysis in detecting cross-subsidization:

> Paragraph 41 and 335 of the First Report, 61 FCC 2d at 780 and 891, contain a discussion of Docket No. 18128, a proceeding instituted to establish certain general rulemaking principles and guidelines. We released our Docket No. 18128 Decision on October 1, 1976, 61 FCC 2d 587 (1976), wherein the Commission held that a revised fully distributed cost methodology (FDC) was the cost methodology more appropriate for determining rate levels of all services. It would enable the Commission to carry out its statutory responsibilities to ensure just, reasonable, and otherwise lawful rates and would permit the Commission to detect unlawful cross-subsidizations between and among services. (Docket No. 18128, 61 FCC 2d at 589, 610 and 641.) We note that FDC analysis assigns all recorded (actual) investment costs and operating expenses, measured over a given study period according to an allocative basis, e.g., causation or relative use, applied commensurately to all services. More particularly, the Commission rejected AT&T's proposed long-run incremental cost (LRIC) methodology, after concluding that it did not faithfully reflect valid marginal cost pricing theory, did not assure carrier accountability for rates, and did not provide adequate safeguards against cross-subsidization of Bell's

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[28] *In the Matter of American Telephone & Telegraph Company, Long Lines Department Revisions of Tariff FCC No. 260 Private Line Services, Series 5000 (TELPAK), FCC 76-886, Memorandum Opinion and Order*, Docket No. 18128, at ¶ 184 (released, October 1, 1976).

[29] *Id.* at ¶ 183, accord see ¶¶ 5, 117, and 124, which detail the infirmities in Bell's LRIC approach.

private line customers by its monopoly service customers (MTS and WATS).[30]

Similarly, the FCC has concluded that joint and common costs must be apportioned among all services as part of an appropriate subsidy analysis. In the *First Report*, the FCC stated:

> According to some public utility ratemaking theories, such costs should be apportioned among all services on the basis of relative usage or business volume. Other theories hold that only the amount by which such costs would be reduced if a particular service were eliminated can be assigned to that service. At a minimum each service has a cause and effect responsibility for some portion of any such joint and common costs. (Footnote omitted). In failing to make any such assignment of these costs to particular service categories, AT&T's "contribution" concept fails to provide any meaningful assessment as to whether the revenues from each category are covering its properly attributable costs: each service could, in fact, show a substantial "contribution" even though none was covering its own costs and they were not collectively covering the firm's total costs. (Footnote omitted) In fact, if the revenues for each of the service categories in the EDC study covered just its assigned costs plus a small contribution, the total enterprise would operate at a 43% deficit. A "contribution" concept which permits such an unrealistic analytical result provided no meaningful information concerning the effect which any loss of business in one service category would have on total costs, net income, or the rate and revenue requirements for other services. In short, one simply cannot determine through AT&T's "contribution" analysis whether loss of business in one service category would result in higher rates for other services (because the revenues for the former service had been exceeding its properly attributable costs); or lower rates for other services (because revenues from the lost business were failing to cover its properly attributable costs.)[31]

In the *Third Report and Order*, the FCC concludes that payphones have high fixed costs. The FCC states:

The profit from a payphone is simply the revenue it generates, less the costs associated with

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30 *In the Matter of Economic Implications and Interrelationships Arising From Policies and Practices Relating to Customer Interconnection, Jurisdictional Separations and Rate Structures*, FCC 80-5, *Second Report*, at ¶ 8 (released January 29,1980).

31 *In the Matter of Economic Implications and Interrelationships Arising from Policies and Practices Relating to Customer Interconnection, Jurisdictional Separations and rate Structures,* FCC 76-879, First Report, at ¶132 (released September 27, 1976).

> the payphone. Because payphones have significant fixed costs that must be recovered, the price for each type of payphone call must exceed the marginal cost of the call (footnote omitted) if the payphone is to earn a normal rate of return. (Footnote omitted) Stated another way, if every call is priced at the marginal costs of that call, the payphone would be unprofitable, because it would fail to recover the predominant fixed cost of providing the payphone. Because the price for each type of call must exceed its marginal costs, it is also clear that an increase in the number or type of call will increase the payphone's profitability by contributing either to the recovery of the payphone's fixed costs or to the payphone's profitability. (Footnote omitted).[32]

Section 276 of the Act and the FCC's implementing regulations are very clear that all subsidies must be identified and removed. This requires assigning common costs including overhead costs to the payphone operation under review. The FCC acknowledges that payphone service has a high portion of common cost:

> The vast majority of the costs of providing payphone service are *fixed* costs that are *common* (also referred to as "joint and common") to the provision of all payphone services. These fixed common costs include the capital cost of buying and installing a payphone in a particular location and certain monthly recurring costs, such as the cost of leasing the local line and monthly maintenance and overhead costs, also know as sales, general, and administrative (SG&A) costs.[33] (*Italics in original*)

In the *Third Report and Order*[34], the FCC recognizes the difficulty in allocating common costs and opines that there is no one economically correct way to allocate such costs; that to avoid cross-subsidies, each service must recover at least its incremental costs and not more than its stand-alone costs. Within these parameters, different allocation procedures (or compensation amounts)

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32 *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, FCC 99-7, *Third Report and Order on Reconsideration of the Second Report and Order*, CC Docket No. 96-128, at ¶ 23 (released February 4, 1999) (*Third Report and Order*)

33 *Id.* at ¶ 31.

34 *Id.* at ¶ 56.

could be considered fair. However, in the *Third Report and Order*, the FCC concludes:

> As explained in Section IV.B below, we find that a fully distributed cost-coverage approach best fulfills our statutory directives within the economic, technological, and statutory constraints that currently exist.[35]

In view of the foregoing, the Ratepayer Advocate asks the FCC to reaffirm that a FDC subsidy analysis is the appropriate analysis to use to identify subsidies and that such an analysis consistent with the FCC's FDC methodology outlined in the *Third Report and Order* must be undertaken by the MPSC as part of its review of intrastate payphone tariffs.

The Ratepayer Advocate submits the FCC's Federal standards and the FCC's *Third Report and Order* require payphone service to be subsidy free. This requires all services purchased from the NCL tariffs to be categorized as expenses once those expenses are added to all other payphone expenses including joint and common and overhead expenses, and the total of all expenses must exceed payphone revenues. If they do not, then the payphone operation is not recovering its fully distributed costs. In that circumstance, a subsidy exists and the subsidy must be eliminated to avoid a violation of the FCC payphone orders. As the first step, Ameritech and GTE must provide financial statements, including income and expense statements on their payphone operations in Michigan consistent with a FDC subsidy analysis. Then, the MPSC should conduct an evidentiary hearings on the merits consistent with state law.

If a subsidy is determined to exist, that subsidy must be removed. The method by which a subsidy is removed, is in the discretion of the payphone operator. In general, there are two obvious ways to remove a subsidy: either increase revenue or decrease expenses. If the NCL line is provided at inflated prices, then one can reduce a subsidy by lowering the tariff price for the NCL line or by

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35 *Id.* at ¶ 73.

lowering other tariff prices to reduce expenses. However, the price can not go below the floor established by the new services test. Alternatively, the ILEC can increase rates to end users for payphone calls. The MPSC has the authority to direct the removal of subsidies if the ILEC does not take corrective action. Similarly, the MPSC has the authority to direct refunds and other appropriate remedies for the failure of the ILEC to comply with the FCC Federal standards.

The MPSC's Review Must Determine If Payphone Tariffs Comply With Sections 202 And 202 Of the Act

As part of the MPSC's review, the MPSC must also determine whether Ameritech's and GTE's payphone tariffs comply with Sections 201 and 202 of the Act. Under Section 201 of the Act, rates, classifications and other terms and conditions contained in these tariffs must be just and reasonable.[36] Under Section 202 of the Act, rates, classifications and terms and conditions cannot be unjust or cause unreasonable discrimination for **like communications services.**[37] If the NCL and COCOT tariffs are not cost based and contain subsidies, these tariffs violate Sections 201 and 202 of the Act. If these tariffs otherwise comply with the FCC Federal standards, the rates in these tariffs must still be just and reasonable when compared with **like communications services**. An obvious violation of Sections 201 and 202 of the Act occurs, when the same service or like services are provided at two different rates. The MPSC must review other tariff filings for **like communications services** to see if the payphone tariff rates, classifications or terms and conditions are priced at different rates for the same or similar service. Since payphone service is a retail service, one must

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[36] 47 U.S.C. § 201(b).

[37] 47 U.S.C. § 202.

look at other retail services. The obvious retail services are the residential and business tariffs. If there is a substantial disparity in rates for payphones when compared to residential and business tariffs, the disparity must be justified to avoid unjust discrimination in like services under Section 202 of the Act.

The Ratepayer Advocate is not contending that one can determine compliance with the FCC Federal standard by looking at existing tariffs filed at the state level. As noted above, the FCC Federal standards do not permit this. However, after a State commission independently determines that intrastate payphone tariffs comply with the FCC Federal standards, it is our position that the State commission must then review other tariffs to determine if the payphone tariffs otherwise comply with Sections 201 and 202. As noted above, the MPSC failed to conduct an analysis and improperly relied upon previously filed tariffs. Once that defect is corrected, the MPSC must evaluate the intrastate tariffs for compliance with Sections 201 and 202 of the Act. The Ratepayer Advocate submits that, on the face of the tariff filings before the MPSC, a review is warranted. The tariff charge for the NCL line in Ameritech's tariff is more than $7 dollars higher than its charge for the COCOT line. Similar discrepancies in pricing exist with the GTE's tariff for the COCOT line and the line it uses, the COPT line.[38] The Ratepayer Advocate asks the FCC to reaffirm that the MPSC must determine whether Ameritech's and GTE's tariffs comply with Sections 201 and 202 of the Act, as part of the tariff review required by the FCC Federal standards.[39]

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[38] GTE's use of a single flat rate for the COPT line instead of deaveraged rates which are used for COCOT lines raises concern of unjust discrimination.

[39] After the MPSC's investigation, if the MPSC finds that an NCL tariff rate, classification or other term or condition is discriminatory, the tariff would violate the FCC direction that a payphone operator not be precluded from offering payphone service using either "smart" or "dumb" payphones or some combination of the two.

The SLC, Formerly The EUCL Charge, Must Be Charged To All Payphone Operators But The Direct Cost Of The Local Loop Must Exclude Direct Costs Recovered Through the SLC.

The FCC in the Payphone Order concluded that the End User Common Line Charge ("EUCL") now called the Subscriber Line Charge ("SLC") must be paid by IPSPs and the ILEC alike.[40]

The FCC reaffirmed this conclusion in the *Reconsideration Order*, when the FCC held:

> Finally, we conclude that, to avoid discrimination among payphone providers, the multiline business SLC must apply to subscriber lines that terminate at both LEC and competitive payphones. We conclude that the removal of payphone costs from the CCL and the payment or imputation of a SLC to the subscriber line that terminates at a LEC nonregulated payphone will result in the recovery of LEC payphone costs on a more cost-causative basis consistent with the requirements of the 1996 Act. (Footnote omitted)[41]

The FCC reiterated this position at ¶207 of the *Reconsideration Order* and stated:

> We agree with Bell South that the application of a SLC to payphone lines is necessary to recover regulated costs assigned to the interstate jurisdiction. In addition, SLC charges will apply equally to LEC and non-LEC payphone lines and, therefore, the incremental SLC cost is the same for LEC and non-LEC payphone providers. [42]

The SLC charges are expenses to both LEC and non-LEC payphones. Moreover, these charges are revenues to the regulated entity and the SLC revenues reimburse the regulated entity for costs assigned to the interstate portion of the loop. Therefore, in determining the direct cost for the intrastate portion of the loop in the review of intrastate payphone tariffs, the direct cost should not include any direct costs recovered through the SLC charge. The price floor for the NCL line and the COCOT line should be based upon the direct cost of the separated loop. The Ratepayer Advocate

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40 See discussion in *Payphone Order* at ¶¶ 173 -187.

41 *Reconsideration Order* at ¶ 207.

42 *Id.*

believes that this is what the FCC intended. If this is so, the Ratepayer Advocate asks the FCC to reaffirm that only the direct cost of the separated loop is included in establishing the price floor for the payphone line.

Conclusion

In view of the foregoing, the Ratepayer Advocate asks the FCC to reaffirm that:

(1) the MPSC was obligated to commence a proceeding to review the intrastate payphone tariffs filed by Ameritech and GTE;

(2) the burden of proof to demonstrate compliance with the FCC Federal Standards is on Ameritech and GTE;

(3) Federal standards must be applied, and inconsistent and conflicting state standards are preempted under Section 276(c) of the Act;

(4) the new services test applies in determining the direct cost and overhead loadings as a price floor for a service offering;

(5) a consistent pricing methodology must be used and applied, but TSLRIC pricing methodology is permitted though not required in determining rates for services in and between payphone tariffs;

(6) the tariff rate for the same or similar services must be priced consistently, uniform overhead and profit loadings are required for the same or similar services, and non-uniform overhead and profit loading are permissible for different services, if justified;

(7) payphone tariffs must contain no subsidies, be nondiscriminatory and otherwise comply with Sections 201 and 202 of the Act;

(8) a FDC subsidy analysis is to be used to identify subsidies;

(9) MPSC may not rely on previously filed and approved state tariffs as a substitute for performing its own analysis to determine compliance with the FCC's Federal standards and that analysis must show that intrastate tariffs are cost based, contain no subsidies, are nondiscriminatory, and are otherwise consistent with the Act, including the FCC's nonstructural safeguard standards; and

(10) only the direct costs for the separated loop are used to establish the price floor for the payphone line (costs reimbursed through the SLC are not included).

Consistent with the above, the Ratepayer Advocate asks the FCC to grant in part and deny in part the declaratory relief requested by the MPTA's in the petition.

Respectfully submitted,

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